UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

No. 98-12256
Chapter 7

RICHARD L. COX
LINDA E. COX

Debtor(s)

SCOTT N. BROWN, JR., TRUSTEE

Plaintiff

v

Adversary Proceeding
No. 98-1167

RICHARD L. COX
LINDA E. COX

Defendants

MEMORANDUM

Appearances: Scott N. Brown, Jr., and Daniel M. Stefaniuk, Spears, Moore, Rebman & Williams, Chattanooga, Tennessee, Attorneys for Plaintiff

Rex A. Wagner, Cleveland, Tennessee, Attorney for Defendants

HONORABLE R. THOMAS STINNETT,
UNITED STATES BANKRUPTCY JUDGE

The trustee in bankruptcy brought this suit against the debtors, Dr. and Mrs. Cox, to recover Dr. Cox's prepetition accounts receivable that he collected during the bankruptcy case and failed to turn over to the trustee. At the trial, the court held for Mrs. Cox because the evidence did not show that she was involved in the alleged conversion of the accounts. The court held for Dr. Cox on a different ground; the court concluded that the trustee failed to carry the burden of proof as to the value of the accounts or the amount collected. Now before the court is the trustee's motion to alter or amend the judgment or for a new trial. *Fed. R. Bankr. P.* 9024; *Fed. R. Civ. P.* 59. The motion deals only with Dr. Cox. The trustee contends that statements by the court in an earlier hearing caused his attorneys to believe the debtors would have the burden of proving the value of the accounts receivable or the amount collected, but at the trial the court put the burden of proof on the trustee. The trustee asks the court to reverse itself and grant judgment for the trustee because Dr. Cox failed to carry the burden of proof or to grant the trustee a new trial.

The court finds the facts as follows.

The trustee's complaint sought a judgment for "the sum determined to have been received and collected by the debtors and for a turnover to the Trustee of any uncollected accounts receivable records and the data necessary to collect the outstanding accounts receivable."

During pretrial discovery the trustee's attorney requested that the debtor admit the amount of the prepetition accounts receivable. The first request asked the debtors to admit: "The amount of the accounts receivable on the date of the petition was in excess of $70,000." It was followed by a series of requests that were identical except the amount decreased by $5,000 in each

request; the final request asked for an admission that the accounts receivable were in excess of $25,000. The debtors failed to make a timely response to the requests for admission. As a result, they admitted that the accounts receivable were in excess of $70,000. *Fed. R. Bank. P.* 7036; *Fed. R. Civ. P.* 36(a).

The proceeding was set for trial on June 29, 1999. The trustee and the debtors filed their trial briefs a week before the trial date. The first portion of the trustee's brief argued that the debtors' evidence was not sufficient to show the amount of the accounts receivable. The second portion of the trustee's brief argued that the debtors had admitted the accounts receivable exceeded $70,000. The trustee's brief concluded with the statement: "For the foregoing reasons, the Trustee is entitled to a judgment against the defendants for at least $70,000.01."

The debtors' trial brief stated that the trustee had the burden of proof. The other portions of the brief stated that there was only one issue, the value of the accounts receivable as distinguished from the amounts actually billed.

Four days before the trial date, the trustee filed an objection to the debtors' pretrial disclosures, especially the summaries of accounts. The trustee objected to the summaries because they did not have documents to back them up. The trustee also objected to Medicare claims reports and to bank statements because they had not been disclosed or produced during discovery.

On the day before the trial date, the debtors filed a motion for a continuance. At the time set for the trial, the court took up the debtors' motion for continuance and the trustee's objection

to the debtors' pre-trial disclosures. As a result of this hearing, the court entered the following order on June 30:

> This adversary proceeding came to be heard upon defendants' motion to continue trial and plaintiff's objection to defendants' pre-trial disclosures. After hearing argument of counsel, the court stated that it would continue the trial based upon certain conditions. Accordingly,
>
> It is ORDERED that the trial in this adversary proceeding is continued to August 17, 1999, at 9:30 a.m., provided the defendants comply with the conditions set out as follows:
>
> 1. Defendants, Richard L. Cox and wife, Linda E. Cox, shall pay to plaintiff and his attorney the sum of $750 in attorney fees for their preparation for this hearing within twenty (20) days from the date of this order;
>
> 2. Defendants, Richard L. Cox and wife, Linda E. Cox, shall supply plaintiff with copies of the summaries identified on the exhibit list in the defendants' pretrial disclosures, together with all back up material used in preparation of the summaries within twenty (20) days from the date of this order; and
>
> 3. Having admitted the amount of the accounts receivable on the date of the petition was in excess of $70,000, defendants, Richard L. Cox and wife, Linda E. Cox, shall supply plaintiff with documentation to support their claim that the actual cash value of the accounts receivable on the date of the petition is less than $70,000.00 within twenty (20) days from the date of this order.
>
> It is FURTHER ORDERED that if the condition of paragraph 1. is not met within the time allowed, the court will enter a judgment against the defendants in the amount of $70,000.00, without further hearing.

On August 4 the trustee filed a motion seeking judgment against the debtors for $70,000 as a sanction for failure to satisfy the second and third conditions. Statements by the court

at this hearing allegedly caused the trustee's attorney to believe the debtors had the burden of proving an amount less than $70,000. Speaking to the trustee's attorney, the court said:

> They're going to have a hard time proving, on the documents they have, that they don't still have those accounts receivable . . . . You've boxed them into a corner pretty well, and now they've got to try to prove something instead of making you prove it. . . .

Later in the hearing the debtors' attorney said:

> We made it very clear to the trustee all along that there were accounts there. Our big dispute has been over what are they worth. And our position is that a lot of them are uncollectable. . . .

With regard to the admission that the accounts exceeded $70,000, the court said to the debtors' attorney:

> You've put your clients in the position, or they've put themselves in the position, where they're going to have to prove something less than $70,000 is owed after having admitted they have those accounts receivable. And I'm not sure what documents you have that would show that. You've apparently submitted everything you can get, and I'm not going to let you do any more. I'm not going to let you come down to trial and start putting things in that haven't been revealed. . . . That's how we got started on this — was you tried to file summaries that have no backing to them, and that's why the trustee brought the motion to begin with, to exclude those summaries. And to the extent that the summaries are not supported by documentation, you're not going to be able to get the summaries in.

Subsequently, the debtors' attorney again argued that valuation of the accounts receivable was the only issue:

> One of our reasons for opposing his motion was that there has been no evidence presented of the value of whatever accounts were there, and that is the issue we want to bring before the court, just as to the value of the accounts. It doesn't matter what you bill the client for; it's what you can collect on that. And that is the allegation of the trustee in the complaint — is that the debtor collected cash on the accounts.

Still later in the hearing, the court said to the debtors' attorney:

> Well, to get up and say, "Well, we only collect 20% of our accounts receivable or 30%, or we have to give adjustments" — I mean that's what record keeping is about. I mean show us the records. But when you say, "Well, we've got $70,000 in accounts receivable, and I can't tell you where they've gone to" — I mean you've got a problem.

One of the witnesses at the trial was Ms. Darla Noland, Dr. Cox's current bookkeeper. Her testimony indicated that she may be able to calculate the amount Dr. Cox received postpetition on many, if not all, of the prepetition accounts receivable that are in question.

DISCUSSION

The court should grant a new trial if its statements unintentionally caused one party's attorney not to present its case as he would have presented it except for the court's statements. *Lutz v. Commissioner of Internal Revenue*, 593 F.2d 45 (6th Cir. 1979). In that case the judge told counsel in chambers that the government's witness was terrible, and the government should concede. In the end, however, the judge ruled in the government's favor primarily because he found the witness was credible and had done a thorough investigation. The court of appeals held that the new trial should

have been granted because the taxpayers' counsel "let up" after the judge's comment regarding the witness's testimony. The court apparently thought the judge's statements justified the attorney's belief that the taxpayers would win despite the witness's testimony.

The question is whether the court's statements in this proceeding unintentionally confused the trustee's attorney as to what the trustee was required to prove. The answer depends first on the law as to what the trustee was required to prove.

The trustee's complaint alleged conversion by the debtors of the bankruptcy estate's interest in the accounts receivable. In a conversion case, the plaintiff has the burden of proving the value of the converted property. 18 Am.Jur.2d *Conversion* § 163 (1985); *see, e.g., United States v. New Holland Stables, Inc.*, 619 F.Supp. 1162 (E. D. Pa. 1985); *Sears, Roebuck and Co. v. Taylor (In re Taylor)*, 211 B.R. 1006 (Bankr. M. D. Fla. 1997). This broad rule is not much help with regard to the exact method of proving the value of accounts receivable. The question is where to begin the proof of their value.

For lack of a better term, the court will use "book value" to mean the amount shown by the books and records as owed on the accounts receivable. Of course, the book value generally will not be the true value because there will be adjustments to some accounts and every account can not be collected in full.

With this in mind, the court thinks there are three basic approaches to proving the value of accounts receivable. The first approach is the simplest. The plaintiff seeks to recover the amount actually collected by the defendant and to recover the documents needed to allow it to collect

the remainder of the accounts. The trustee's complaint takes this approach to the amount of the damages.

Recovery of the amount collected may be less than full recovery for the plaintiff for several reasons. The defendant may have collected less than it should have, the passage of time may have made some of the accounts uncollectable, and the defendant may not have good enough records for the plaintiff to determine what was collected and what is still owed. This brings up the second and third approaches to proving the value of converted accounts receivable.

In the second approach, the court and the plaintiff begin with the assumption that the plaintiff can not recover the book value because it can not be the true value. The plaintiff will begin the proof with the book value but will then proceed with evidence of adjustments and collectability in order to show the true value of the accounts receivable. *Medi-Cen Corp. v. Birscbach*, 702 A.2d 966 (Md. Ct. Spec. App. 1998).

This is not a three step process in which (1) the plaintiff proves the book value, (2) the defendant puts on evidence that the book value is not the true value because there are adjustments and problems of collectability, and then (3) the plaintiff introduces more exact evidence as to adjustments and collectability so that the court or jury can calculate the true value. Instead, the second step is left out because the court and the plaintiff begin with the assumption that the book value can not be recovered because it is not the true value. The plaintiff's proof goes directly from book value to adjustments and collectability.

The third approach to proving value is the three step process. It has the effect of a presumption that the book value is the true value, and the plaintiff can recover that amount, unless the defendant rebuts the presumption. The defendant rebuts the assumption by showing that the book value is not the amount that can legally or practically be collected. The rebuttal evidence need not be sufficient to allow the court to calculate the true value. The defendant need only show that adjustments and collectability problems made the accounts worth less than the book value. Then, the plaintiff has the burden of proving the true value. The plaintiff must introduce enough evidence as to adjustments and collectability that the court or jury can reasonably calculate the true value.

The court must emphasize that the third approach does not require the defendant to prove the total adjustments and uncollectable accounts so that the true value can be calculated. In other words, the defendant is not required to prove the amount of its liability. The plaintiff is required to do that.

In summary, none of these approaches to proving value requires the defendant to prove the true value or the amount of its liability. The plaintiff can not rest on the book value and assume the court will require the defendant to prove the true value. In the trustee's motion for new trial, his attorney admits to thinking the opposite. He thought that the trustee would be entitled to a judgment for the book value, which the debtors admitted to be more than $70,000, unless the debtors proved a lesser amount.

This is not what the court had in mind. The court expected the proof to follow the second or third approach. Under either of these, the trustee had the burden of proving the true value

by putting on evidence as to adjustments and collectability so that the court could reduce the book value to the true value. The court never expected the trustee to recover the admitted book value of more than $70,000. Nevertheless, the question is whether the court's statements in the earlier hearing justifiably led the trustee or his attorney to think he would be entitled to a judgment for $70,000 unless the debtors proved the amount to which it should be reduced as the result of adjustments and collectability problems.

The court's statements at the earlier hearing can be interpreted as adopting the third approach described above. The court seemed to be saying that the trustee would be entitled to a presumption that the true value was $70,000, and he could recover that amount unless — unless what? It could be (1) unless the debtors rebutted the presumption merely by showing there were necessary adjustments and collectability problems, or (2) unless the debtors proved the value by presenting enough evidence as to adjustments and collectability to allow the court to calculate the reduction from $70,000. The trustee thought the court meant (2) when the court really meant (1). In hindsight, the court should have made this clear. Taking all the court's statements together, they could be understood either way. The first quoted statement, however, appears to agree with the trustee's view; the court seemed to be saying that the trustee would be entitled to a judgment for $70,000 unless the debtors proved the true value was less.

In this regard, context is important. The trustee had objected to the debtors' pre-trial disclosures dealing with the amount of the accounts receivable and the amount collected. The court entered an order requiring the debtors to supply evidence to the trustee. Paragraph 3 of the order provided:

> Having admitted the amount of the accounts receivable on the date of the petition was in excess of $70,000, defendants, Richard L. Cox and wife, Linda E. Cox, shall supply plaintiff with documentation to support their claim that the actual cash value of the accounts receivable on the date of the petition is less than $70,000.00 within twenty (20) days from the date of this order.

This order required the debtors to provide evidence that the value of the accounts was less than $70,000. It did not exactly shift the burden of proof at trial, but it was similar.

The trustee then filed a motion for judgment against the debtors in the amount of $70,000 as a sanction for the failure to comply with the order. At the hearing on the motion for sanctions, the court again seemed to be shifting the burden of proof to the debtors as to the value of the accounts receivable. This might have been done explicitly as a sanction, but it was not. Instead, the court did something similar. It limited the evidence that the debtors could produce at the trial to show the value of the accounts. Of course, this also made it appear the debtors had the burden of proving a value less than $70,000.

In this regard, the court emphasized that any business should have accurate records of accounts receivable that would allow them to be calculated without much difficulty. The inadequacy of Dr. Cox's records made it difficult for the trustee to prove the value of the accounts receivable or even the amount collected. There is a general rule that lightens the plaintiff's burden of proof in a situation such as this. The court means a situation in which the defendant should be the best source of evidence for the plaintiff to prove the amount of damages, but the defendant's conversion of the property or the defendant's poor record keeping has caused a lack of evidence.

The courts accept less accurate proof of value rather than allow the defendant to escape all liability as a result of its own bad act or poor record keeping. *Alexander Schroeder Lumber Co. v. Minerales y Metales, S.A.I.C.*, 331 F.2d 135 (5th Cir. 1964); *Dressel v. Weeks*, 779 P.2d 324 (Alaska 1989); *Ogden v. Wilson*, 649 S.W.2d 780 (Tex. Ct. App. 1983); *see also Plunkett-Jarrell Grocery Co. v. Terry*, 263 S.W.2d 229 (Ark. 1953). The court brings up this rule because it must have been in the court's thinking at the time. It was too obvious to miss. Though it does not shift the burden of proof entirely, it suggests a basis for shifting the burden to the defendant in an egregious case.

The court also can not ignore an old bankruptcy case that involved a creditor's alleged conversion of the debtor's accounts receivable. The court said:

> The parties were not in agreement as to how to prove the value of the accounts receivable claimed to have been appropriated by the defendant. Should the point become in issue hereinafter, we state that it seems to us incumbent upon the defendant to show a value less than their face if he intends to rely on the point.

Liebowitz v. Voiello, 107 F.2d 914,916 (2d Cir. 1939). The court in that case thought that the defendant who converted the accounts receivable should have the burden of proving they were worth less than the face amount or book value.

Thus, the facts show that the trustee and his lawyers may have been justifiably misled as to who had the burden of proof on the question of value. Of course, it seems to have been partly their fault. The requests for admissions, the repeated emphasis on $70,000 as the amount the trustee

should recover, and the motion for a $70,000 judgment as a sanction reveal a misconception that the court would treat the $70,000 book value as the amount recoverable unless the debtor put on evidence that allowed the court to calculate a smaller amount. It appears to the court that the trustee or his attorneys put too much effort into pursuing this misconception by trying to obtain a judgment for the $70,000 book value when a reasonable estimate of the actual amount collected may not have been that difficult to obtain, at least this seemed to be the point of Ms. Noland's testimony at the trial.

The court may not have been required to correct the misconception by the trustee or his attorneys. Nevertheless, the court's orders and statements, in light of the context in which they were made, seemed to agree with their misconception. They were justified in believing the court would grant judgment for the $70,000 book value unless the *debtor* put on proof that would allow the court to calculate a smaller amount.

It appears the court should grant a new trial to the trustee. The court will not reverse its judgment and grant judgment for the trustee. The court did not mean to shift the burden of proof on value to the debtors, and the debtors' attorney correctly understood that the trustee had the burden of proof. Dr. Cox will not be penalized for the mistake by the trustee, which was compounded by the court's apparent agreement.

An order shall be entered granting the trustee a new trial as to Dr. Cox only.

This memorandum constitutes findings of fact and conclusions of law as required by *Fed. R. Bankr. P.* 7052.

ENTER:

BY THE COURT

entered Feb. 24, 2000

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

No. 98-12256
Chapter 7

RICHARD L. COX
LINDA E. COX

Debtor(s)

SCOTT N. BROWN, JR., TRUSTEE

Plaintiff

v

Adversary Proceeding
No. 98-1167

RICHARD L. COX
LINDA E. COX

Defendants

ORDER

In accordance with the court's memorandum entered this date,

It is ORDERED that the plaintiff's motion is GRANTED in part, to the extent that the trustee will be allowed a new trial as to Richard L. Cox only; and

It is FURTHER ORDERED that the trial is scheduled for April 11, 2000, at 9:30 a.m., in Courtroom B, Historic U.S. Courthouse, 31 E. 11th Street, Chattanooga, Tennessee.

ENTER:

BY THE COURT

entered Feb. 24, 2000

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE